Section 2- Flow-Through Entities

Schedule K-1

As the preparation of 2002 federal income tax returns begins, the Internal Revenue Service is offering the following reminders regarding Schedules K-1 from Partnerships, S Corporations and Trusts:

- Report income in the proper location on individual returns as instructed by Schedule K-1, column (c).

- Avoid netting or combining income and deductions on Schedule E, except for passive activity income and deductions from Form 8582. Generally, income and related deductions (such as unreimbursed partnership expenses and the section 179 expense deduction) must be reported separately. For more details, refer to the Schedule E instructions.

- Report losses carried forward from prior years due to the at-risk and basis limitations on a separate line of Schedule E. Do not combine them with amounts reported for the current year.

- Refer to Form 8582, Passive Activity Loss Limitations, for instructions on properly reporting income and losses from passive activities. Beginning with tax year 2002, filers of Form 8582 must attach all three pages of Form 8582 (including the worksheets) to their tax returns.

- Report flow-through income even if a Schedule K-1 has not been received at the time the Form 1040 is filed. Except for partners in certain small partnerships, Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), must be attached to the tax return to indicate that the partner, shareholder, or beneficiary either did not receive a Schedule K-1 or disagrees with the amounts reported on the Schedule K-1.

- Identify amended information by checking the "Amended K-1" box on the Schedule K-1. The flow-through entity is responsible for ensuring that the box is clearly marked.

In closing, as with all IRS forms, please ensure correct taxpayer identification numbers are entered on K-1s. Following these instructions will help you and your clients properly report K-1 income as the IRS continues its program of matching Schedule K-1 forms to individual returns.